SUMMARY of COOPERATIVE CASES

FARM CREDIT ADMINISTRATION
U. S. DEPARTMENT OF AGRICULTURE
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Prepared for the

COOPERATIVE RESEARCH AND SERVICE DIVISION

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COOPERATIVE RESEARCH AND SERVICE DIVISION

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The comments on cases reviewed herein represent the personal opinion of the authors and not necessarily the official views of the Department of Agriculture.

THE NEW TAX TREATMENT FOR EXEMPT FARMER COOPERATIVES*

The views expressed herein are entirely those of the author, and nothing herein contained is to be construed as the official opinion of the Bureau of Internal Revenue.

The passage of section 314 of the Revenue Act of 1951 in late October of that year marks the fifth occasion since adoption of the 16th amendment, upon which the Congress of the United States has enacted taxing legislation with specific reference to farmers' cooperatives. It is significant that, in each instance, there has been a recognition by the Congress, not only of the existence and of the growth of the cooperative institutions of our nation, but, in addition, a very real recognition of the unique nature of the cooperative corporate structure. Section 314, although an integral part of a revenue raising measure designed to meet the needs of a rapidly accelerated defense economy, does not deviate from this pattern. From the legislative history of this section, from its language as well as from its technical structure, there is clearly discernible a manifest intention by the Congress to preserve within the framework of the new law the same principles of mutuality by which cooperative taxing legislation has been uniformly characterized in the past. Equally clear, however, is the fact that today, since passage of section 314, no farmers' cooperative, no matter how organized and operated, is entirely exempt from Federal income taxation. Henceforth, compliance with the rules previously entitling an association to exemption under section 101(12) results generally in taxation in the very same manner as in the case of all other corporations, except that the burdens of this compliance bring forth important benefits in the form of certain deductions and other adjustments in the computation of net income under the Internal Revenue Code. Although through application of these special deductions and adjustments, it may be possible for an exempt cooperative to effect tax-free distribution of what would otherwise constitute its taxable income, since passage of section 314 a decisive difference appears. Whereas previously the route to no corporate tax was a relatively short one, through the securing of a letter of exemption, today, this road is considerably longer. This same result may be achieved, if at all, only through distribution of your receipts from patronage and by reduction to zero of your statutory net income.

The term "statutory net income" is used advisedly, as it should be the key to your current and prospective Federal tax thinking. It means neither your "net margins," "net savings," nor your "net earnings." Rather, it is a term precisely expressed by the Congress to mean gross income as defined in section 22(a) of the Internal Revenue Code less only such deductions as are specifically authorized in section 23 of the Code, and as have been additionally authorized in section 314. My purpose in these remarks this afternoon is two-fold: of course, to examine with you the specific provisions of section 314, but in addition, and possibly more important, to attempt to relate these provisions with some basic income tax concepts in order that we may evaluate the manner in which the new law has been integrated with the old and within the total structure of the entire Internal Revenue Code.

I have already indicated the first basic principle, that is, that the exemption provisions treating farmers' cooperatives have not been repealed. Rather, the major operative provisions of section 314 have been added as subsection (B) to the existing law under section 101(12), which now becomes subsection (A). Since the two subsections, (A) and (B), of 101(12) are applicable concurrently in the determination of the Federal tax liability of an exempt cooperative, it seems appropriate, preliminarily, to review very briefly some highlights of the legislative and administrative history of previous provisions dealing with farmers' cooperatives in order that the new subsections, 101(12)(B), may be placed in a meaningful perspective.

No specific reference to cooperative organizations appeared in the first Revenue Act passed since adoption of the 16th amendment, that of 1913. The only relevant provisions in that Act were those exempting "agricultural and horticultural" organizations. Originally the Treasury Department construed this language to include within its scope cooperative dairies without capital stock. This rule was soon changed, however, by a decision of the Department holding that although cooperative dairies could offset gross income by the amount of patronage refunds "actually paid," any amount retained at the end of the year over and above expenditures was returnable as net income. We may note that to this early holding may be traced the origin of the tax treatment of the non-exempt cooperatives.

Outright legislative exemption did not appear until the Revenue Act of 1916. Under section 11 of that Act, income tax exemption was granted to farmers', fruit growers', or like associations, organized and operated as a sales agent for the purpose of marketing products of its members and turning back to them, on a patronage basis, the proceeds less selling expenses. In the light of present conditions the reasons for its enactment may appear somewhat surprising. In the report of the Senate Finance Committee issued at that time, this statement appears:

> It was deemed advisable to specifically extend the exemption * * * in view of the fact that the experience of the Treasury Department has been that the securing of returns * * * has been a source of expense and annoyance and has resulted in the collection of either no tax or an amount which is practically negligible.

Both the Revenue Acts of 1916 and of 1951 were passed in a "preparedness" or "national defense" economy. Nevertheless, whereas the early law brought forth freedom from taxation, the later enactment reinstated the tax. It should be recalled, however, that the tax rate on corporations in 1916 was 2 percent as compared with more than 50 percent today. In view of this contrast, it may be said that most current dealings involving Federal tax matters now involve at least annoyance and very probably expense. Possibly, therefore, these factors no longer remain of particular relevance.

*Address by Leonard L. Silverstein, Office of the Chief Counsel, Bureau of Internal Revenue, Washington, D. C., at the Conference of Cooperative Attorneys and Finance Officers, at the 24th Annual Meeting of National Council of Farmer Cooperatives, New Orleans, Louisiana, January 12, 1953; reproduced with the consent of the author.

The law itself in 1916 was extremely narrow, providing exemptions for agency marketing cooperatives which dealt only with members. Cooperatives which could not satisfy these requirements were taxable, substantially as they are today, upon statutory net income after patronage distributions.

In 1918, a significant attempt was made to alter the method of tax treatment of cooperatives generally. In the Revenue Bill of that year, as reported from the Senate Finance Committee, it would have been provided that all cooperatives, whether or not farmers' organizations, which acted as sales or purchasing agents, would be exempt. If such associations did business with non-members, however, they would be fully taxable except that there would be allowable as additional deductions patronage dividends distributed to members. We can speculate together as to whether the entire course of cooperative tax treatment would have been altered had this Bill been enacted. Not only would there have been a legislative determination characterizing patronage distributions to members, as deductions and not exclusions from gross income but, in addition, no exemption would have been granted to cooperatives acting on behalf on non-members. Failing passage, it was not until three years later, under the Revenue Act of 1921, that the exemption provisions of the 1916 Act were broadened, this time to include farmers' cooperatives acting as purchasing agents for members. The bare language of this statute even in this expanded form was not sufficiently comprehensive to provide legislative rules governing the increasingly complex structures of farmers' cooperatives as they were organized and operated in the post World War I economy. It remained to the Treasury Department to promulgate interpretative regulations treating precise exemption requirements. Thus, in Regulations published in 1921, the issuance to farmer-producers of capital stock having limited dividends rights was authorized. In 1922, in regulations under the Revenue Act of 1921, the accumulation of limited reserves was also authorized. The term "producer" rather than "member" first appeared in regulations under the 1924 Act so that after this time limited dealings with non-members became consistent with exemption.

As we all know, the departmental practice as expressed in the foregoing series of regulations was crystallized into law in the Revenue Act of 1926. Summarized, these provide that a cooperative may act as principal as well as agent and thus take title to goods marketed or purchased, that it may accumulate reasonable reserves, that it may issue voting stock to producers with limited dividend rights, and that it may carry on 50 percent of its business with non-members. Apart from the addition, in 1934, of provisions permitting business done with the United States to be disregarded in determining the right to exemption, no change in the 1926 law was made until section 314 was enacted. During this interim period of a full quarter of a century, there was developed a large body of court decisions and rulings construing the law and regulations as applied to specific factual situations involving both exempt and taxable cooperatives. In the case of the latter type organization, the so-called "taxable" cooperative, it has become well established that, although these organizations are taxable upon statutory net income as other corporations, there may be excluded from the computation of their net income, patronage distributions made pursuant to an obligation evidenced in the articles of incorporation, by-laws, or other contract. It should be emphasized that section 314 does not affect the status of these organizations.

Into this rather intricate latticework of court decisions, regulations, rulings, as well as of the Internal Revenue Code itself, there was injected on October 20, 1951, the provisions of section 314. As we have already noted the old law has not been repealed; the provisions of the new are therefore in addition to, rather than in place of, all that has preceded. Thus, to receive the special tax treatment afforded by section 314, your association must be so organized and operated as to meet all of the exemption requirements previously outlined. Having accomplished this, certain consequences, which we shall next discuss, follow.

The first to be considered is the fact that for all purposes except those subjecting an exempt cooperative to taxation under section 314 such associations remain exempt organizations. The most important effect of this rather unusual manner of treatment is automatic freedom from the excess profits tax. This is so simply because this tax is not applicable to exempt organizations.

The basic operative provisions of section 314, however, occur in subsection (b). This provides, first, that notwithstanding exemption a farmers' cooperative is subject to tax under section 13, 15, or 117(c)(1) of the Internal Revenue Code, that is, in the same manner as is provided for business corporations generally. The prime effect of this language is to call into play all of the general income tax provisions under Chapter I of the Code except subchapter D, relating to the excess profits tax. Many of these do not by their terms contemplate the subjection to taxation of a corporation previously in operation as an exempt organization. For example, an exempt cooperative may have consistently kept its books on a fiscal year basis ending, let us say, on June 30. The bare words of section 314 merely state that the law is effective for taxable years beginning after December 31, 1951. What is the taxable year of such a cooperative, the calendar year beginning January 1, 1952, or the fiscal year beginning July 1, of that year? The proposed regulations under section 314 here interpret this language and provide that the taxable year of an exempt cooperative, whether fiscal or calendar, is to be determined without regard to the fact that such an association may have been exempt for a prior period. In this case, the first taxable year beginning after December 31, 1951, would be the fiscal year beginning July 1, 1952, and the provisions of section 314 would not become effective until that date.

Since the foregoing is illustrative of one of the major functions of the regulations of the Commissioner, that of filling in "gaps" in the law, thus making it susceptible of administration, it seems appropriate at this point to make brief reference to their over-all purpose. The Commissioner is authorized by Congress to publish all needful rules and regulations for the enforcement and administration of the Internal Revenue laws. These regulations and rules are thus limited in their function to articulation of the laws passed by Congress, for the guidance of taxpayers and officials of the revenue service. There is no authority to deviate from the statute by regulation or ruling. Regulations of the Commissioner, with which we are here concerned, are issued as "Treasury decisions" and are approved by the Secretary of the Treasury. Rank-

ing first in authority as administrative orders, regulations, because of their importance and wide applicability, are given extremely careful consideration before final promulgation. Since 1946, under the Administrative Procedure Act, regulations are first published in tentative form. During a 30-day period thereafter, the public is invited to make comments, after which the tentative regulations are reconsidered and finally promulgated. As many of you know, regulations under section 314, relating to exempt cooperatives, were published tentatively on November 8 of this year. The comments which have been received are now being afforded careful consideration. Since these tentative regulations are subject to change before final adoption, *it is important to note that none of my remarks relating to the proposed regulations may be considered definitive in any way. In addition, since the content of this address does not have the official approval of the Bureau of Internal Revenue, these remarks are purely personal, and do not necessarily reflect or represent the official interpretation of any laws or regulations by the Bureau of Internal Revenue.*

Certain other rules necessary to effect the transition from tax-free to tax-paying status have also been set forth in the proposed regulations. Thus the cooperative is accorded an election on its first taxable return as to the method of accounting, cash or accrual basis, to be utilized, and as to the method of treating bad debts, either by establishing a reserve or charging off debts as they become worthless. Associations using the "Lifo" method of inventory must file an election if they desire to continue or to initiate this method during future years. Specific provisions have also been included governing the carry-forward and carry-back of the net operating loss. Although no carry-forward or carry-back is allowable from an entirely exempt year, in the case of a net operating loss occurring in a taxable year, the association is not required to reduce the amount of this loss by carry-back to exempt years in which there may have been income. It is also provided that the cost or other basis of assets, for the purpose of computing gain or loss on sale and future depreciation or amortization rates, must be adjusted for depreciation and amortization for such items during the years since acquisition of the assets.

It will be recalled that we have previously mentioned the term "statutory net income." We have done so by way of contrast with cooperative business-wise concepts of net margins, net earnings, or net savings. This is essential; for having bridged the gap to tax-paying status, it becomes necessary to calculate your Federal income tax liability solely by reference to the requirements of the Internal Revenue Code. Business concepts of factors constituting income, losses, or expenses, insofar as they conflict with the Congressionally defined provisions of the Code, are entirely irrelevant. Thus, although you as a manager of an exempt cooperative may consider that your association has earned only a stated amount during the year, giving due regard to all of the contingencies with which your association may be faced, it may be determined under the Code that your taxable net income is a figure entirely different, either more or less than the amount which you yourself would have conceived it to be.

Since the base for our Federal income tax determination is gross income under section 22(a), let us first address ourselves to the meaning which Congress has ascribed to this term. It is defined in extremely broad fashion to include "* * * gains, profits * * * of whatever kind in whatever form paid * * * derived from any source whatever * * * ." Undoubtedly it includes items not considered to be income by you in your business thinking. For example, the gain derived from the sale or exchange of property is includible in the computation of gross income in accordance with specific statutory conditions. Such gain as well as loss is measured by the difference between the amount realized in cash and the fair market value of property received in exchange and the "adjusted basis" of the property sold or disposed of. The term "adjusted basis" as defined in section 113(b) also has a specialized meaning. Generally this is the cost of the property, but it is hedged with certain limitations to account for such factors as depreciation or other items properly chargeable against the property under the Code. Assuming a sale by your association and the realization of gain or loss, such gain or loss would be recognized for tax purposes only in the precise manner prescribed in section 112 of the Code. Again, if the property is deemed a capital asset under section 117, additional special rules apply. Thus, although you as a cooperative manager may consider that your association has lost money on a given sale of property, for Federal tax purposes it may be determined that recognizable gain was realized and the amount of such gain will be includible in your gross income. Of course, the converse may be true. You as a manager may consider that a "gain" was realized from a given sale; nevertheless, for Federal tax purposes it may be determined that no gain was realized, and the dollars or other assets received for the property would not be includible in your gross income.

Consideration of items not a part of gross income leads to a discussion of what is undoubtedly the most important single provision of section 314. I address myself now to the paragraph devoted to patronage distributions. It is here provided in substance that patronage distributions with respect to patronage of the same or preceding years in cash, or in non-cash form, made during the taxable year or within 8½ months following its close, shall be taken into account in the same manner as in the case of cooperatives not exempt. Since there is no reference in the statute or in the regulations to the tax treatment of patronage distributions by taxable cooperatives, this paragraph constitutes an unusual example of legislation by reference to a body of law. Upon the regulations, therefore, there has devolved the function of articulating the substance of the law in terms of the practices of exempt cooperatives. This has been done in a manner having the effect of excluding patronage distributions from gross income. Thus, under general provisions of the Code, the gross receipts of a corporation may be reduced in arriving at gross income by the amount of the cost of goods sold. The proposed regulations provide that the patronage distributions of a marketing cooperative are taken into account as an addition to other costs of goods sold; or, in the case of a purchasing cooperative, as a reduction in total gross receipts. It should now become apparent that in computing the tax liability of an exempt cooperative, the most important single step will be the exclusion of patronage distributions in the calculation devoted to arriving at its gross income under section 22(a). It is, of course, essential to be fully familiar with the nature of the patronage dis-

tribution from a federal tax standpoint as well as with the circumstances under which this distribution may be excluded from gross income.

The statute states that a patronage distribution may be allocated in cash, or non-cash form disclosing the dollar amount allocated. The proposed regulations first consider the meaning of the term patronage dividend, refund, or rebate. It is defined to include distributions on a patronage basis in cash or merchandise, the amount of which is fixed by reference to the "earnings" of the cooperative. It is further provided that all patronage distributions in form other than cash, whether or not fixed by reference to the "earnings," shall constitute patronage dividends, refunds, or rebates. Note that the term "earnings" is utilized, rather than statutory net or gross income. As used, it simply means that if the amount of the cash distribution is determined after balancing receipts against expenses, that is, if it is made from the margins or savings of the cooperative, such amounts when allocated constitute a patronage dividend, refund, or rebate. This term does not include distributions in satisfaction or redemption of previously issued non-cash patronage dividends, nor dividends on capital stock, since these latter are made on a proprietary, rather than a patronage, basis. Assuming the existence of a patronage dividend, when does an allocation take place? As defined in the proposed regulations, to constitute allocation there must first be an apportionment or crediting of a portion of the net worth of the cooperative to the account of the patron; secondly, as required by the statute, there must be disclosure of this fact to the patron. It should be emphasized that although disclosure is essential, nothing in the statute and therefore nothing in these regulations requires that this disclosure be in writing.

Having ascertained that a patronage distribution has been allocated to a patron, it next becomes necessary to determine whether or not the allocation may be excluded from statutory gross income. In this respect the mandate of the statute, requiring that these be taken into account in the same manner as in the case of taxable cooperatives, has been in substance followed. Thus, as we all know, it is necessary that the allocation be made pursuant to a pre-existing obligation. However, recognizing the long settled practice of many exempt cooperatives to express this obligation to their patrons in terms of a simple statement requiring patronage distribution of margins after retention of "reasonable reserves," the proposed regulations provide that this would constitute a sufficient legal obligation. Patronage dividends relating to patronage of a preceding year may be excluded from gross income in the same manner as current patronage distributions, where the amounts have been retained in a manner consistent with the exemption requirements.

Before passing the important subject of patronage dividend distributions, I desire to make this general comment. Although the statute makes reference to the law governing taxable cooperatives these regulations are directed solely to exempt cooperatives and nothing there expressed makes the rules applicable to the taxable organizations.

Returning again to the basic provisions of the Internal Revenue Code, let us assume that you as a manager of an exempt cooperative, having made allocations of patronage dividends, take such allocations into account along with all other income and that you arrive at an amount representing your statutory gross income under section 22(a). We next consider the manner in which this amount may be reduced by deductions in arriving at statutory net income, the base upon which your tax is computed. Again we must look solely to the terms of the statute, rather than to business concepts, to determine items constituting deductions from your gross income. As previously indicated, these are set forth under section 23 of the Code. To be applicable, the precise requirements of the law must be complied with. For example, expenses, although incurred in your business, must be ordinary and necessary. Salaries are deductible only to the extent to which they are determined to be reasonable. Contributions to charity present a meaningful example of the necessity of following the statutory requirements. In deducting these contributions, neither the Bureau of Internal Revenue nor the taxpayer is authorized to determine the amount of the deduction except with specific reference to section 23(q). It is there stated that the amount deductible may not exceed 5 percent of your net income, computed without regard to this deduction. If, therefore, because of patronage distributions and other deductions your statutory net income is zero, your charitable deduction, 5 percent of this amount, is also zero.

The foregoing constitutes a few examples under section 23, which are applicable to all corporate taxpayers. However, as we all know, section 101(12)(B) authorizes, in addition to the deductions under section 23, two special additional deductions. The first of these is a deduction for the amount of dividends paid on capital stock. The proposed regulations, taking into account the fact that exempt cooperatives have for long issued proprietary securities other than capital shares, provide for applicability for the deduction for earnings paid with respect to such securities. It must be emphasized here that the statute says "paid" and that this, of course, means during the taxable year. It does not mean "accrued" and it is therefore necessary that the shareholder must either physically receive the dividends in fact or that the dividend be made freely available to him during the taxable year, that is, that he constructively receive the dividend during the year. Looking back for a moment to the Revenue Act of 1926, and the Congressional authorization in that year of the issuance of capital stock, we find that this new deduction was considered essential by the Congress in order to effectuate cooperative principles of mutuality, that is, to permit passing on of the single tax from the cooperative to the patron. It is for this reason, of course, that there must be receipt by the patron and taxability of the dividend to him when the cooperative is entitled to the benefit of the deduction. The second special deduction also effectuates principles of mutuality and also stems basically from the provisions in the exemption requirements enacted in 1926 permitting maintenance of reasonable reserves. If such reserves, or other funds, are invested, and income not derived from patronage is realized by the cooperative, these amounts otherwise taxable to the cooperative may be allocated to the patron and the tax paid by him. As in the case of patronage dividends, allocation of non-patronage income during the year or within 8½ months after its close are deductible during the taxable year. Although income derived from the lease of premises or from the ownership

of securities may be allocated without substantial difficulty, allocation of income derived from the sale of assets held for a substantial period of years presents considerable problems. The proposed regulations, in conformity with the report of the Senate Finance Committee, provide that allocations of all types of non-patronage income must be made on a patronage basis. Recognizing the practical difficulties involved in allocating amounts, often relatively small, earned over a period of many years to the numerous patrons of those years, some elasticity is provided by permitting allocation on a patronage basis "insofar as is practicable."

A word about United States business. The Finance Committee report makes clear that profit derived from business done with the United States is to be characterized as a form of non-patronage income. This has reference to the case of a cooperative doing business with the United States as a patron and, of course, has no reference to the cooperative doing business with the United States as a customer, that is, where a marketing cooperative sells to the United States or a purchasing cooperative purchased from the United States.

Since the non-patronage income deduction is the final special deduction from gross income, it now becomes possible to calculate your tax. Again reverting to our basic outline, having ascertained gross income, having offset this amount by allowable deductions under section 23 and the two special deductions under section 101(12)(B), if any amount remains, this constitutes your statutory net income and forms the base upon which the corporate tax is computed under sections 13, 15, or 117(c)(1). In making this computation, net income may be further reduced to normal and surtax net income upon which the tax is actually paid by the application of certain credits, one of which is the credit for dividends received from "domestic corporations subject to taxation." This credit constitutes 85 percent of the amount of the dividends received. Here again is an example of a situation in which your characterization as an exempt organization affects what would otherwise be corporate tax liability. Thus, if your association, or any corporation for that matter, receives dividends on the capital stock of an exempt cooperative, no dividends-received credit would be available for the reason that the cooperative, by force of section 314, is considered to be an exempt organization rather than a domestic corporation subject to taxation.

The foregoing is the substance of the new law insofar as it affects the tax treatment of the exempt cooperative organization. There is, however, another provision in section 314 of which brief mention should be made. I am certain that all of you are aware of its general nature. Subsection (c) of section 314 requires the filing of information returns by a cooperative, whether or not exempt, of patronage distributions allocated for 1951 and subsequent calendar years. Final regulations under this section were published last spring. The proposed regulations, here under consideration, also include a section related to this subject, that is, the tax treatment of patronage dividends in the hands of the recipient, the patron. Note that these regulations are applicable, as is subsection (c), to patrons of taxable as well as of exempt cooperatives. Summarized, these provide that if the patron receives a patronage dividend in cash or merchandise in connection with products marketed or supplies purchased for his business, he is taxable on the amount of cash or the market value of the merchandise received. If, on the other hand, he receives a retain certificate or other non-cash distribution, and the cooperative was entitled to exclude the face amount in arriving at its gross income, the patron is taxable on what the cooperative was entitled to exclude, the face amount of this certificate when received. In such case no tax would be payable by the patron when the certificate is redeemed or satisfied. If, however, the cooperative was not entitled to exclude the face amount, then the patron is not taxable until the year in which the certificate is redeemed or satisfied.

Let us now recapitulate, very briefly, the total picture. Exempt cooperatives, formerly entirely free from tax, now occupy a unique hybrid status under the Internal Revenue Code. On the one hand, assuming the exemption requirements of section 101(12)(A) are satisfied, such organizations are treated for certain purposes as exempt organizations, and are not subject to the excess profits tax. On the other hand, for income tax purposes they are taxable generally as corporations. Patronage dividends may be excluded in computing gross income under circumstances outlined. In addition, such organizations receive the benefits of two special deductions, one for dividends paid on capital stock, the other for non-patronage income allocated to patrons. These organizations, along with taxable corporations, must file information returns as to patronage dividends allocated of $100.00 or more. A patron receiving a patronage dividend in connection with products marketed or supplies purchased for his business is taxable in the amount of cash or merchandise received and on the face value of certificates received if the corporation was entitled to exclude the certificate in computing its income. If the cooperative was not so entitled, the patron is taxable only when the certificate is redeemed or satisfied.

As previously indicated, the proposed regulations are designed to provide some general rules for application of section 314. We fully realize that even after the regulations are finalized, many problems will still remain in interpreting the provisions of the law. In this connection a statement by a cooperative manager before the Ways and Means Committee is interesting:

> I am not appearing before your committee for the purpose of making any objection to this legislation, but only for the purpose of asking that some points which have been obscure be cleared up, so that the law will be applied uniformly, and so there will be no question as to what it means regarding those points. * * * We find that on some of the points there has been very much variation and dispute. * * *

Surprisingly, this utterance was made not in connection with hearings under the 1951 Revenue Act but in 1918 when the cooperative corporate structure as well as the economy of our nation was vastly less complex, and when the entire cooperative tax treatment was limited to a single narrow paragraph in the 1916 Act. It should be readily understandable, therefore, that many problems can be expected to exist today. On the other hand, I am confident that practical answers to your working problems will be developed and that exempt farmer cooperatives will continue to operate under the new tax treatment as they have so successfully under the old.

FEDERAL TRADE COMMISSION COMPLAINT AGAINST FLORIDA CITRUS MUTUAL

The Federal Trade Commission filed a complaint against Florida Citrus Mutual, Docket No. 6074, dated December 15, 1952, charging that it violates the antitrust laws in attempting to regulate marketing and prices of Florida Citrus.

Under the complaint, a hearing was originally set for February 18, 1953. Florida Citrus Mutual answered the complaint, denying any violation. On February 26, 1953, attorneys for the Federal Trade Commission recommended dismissal of the complaint. However, on March 19, 1953, the Director of the Bureau of Anti-Monopoly and the Chief of the Division of Investigation and Litigation of that Bureau of the Federal Trade Commission issued a memorandum to the Hearing Examiner in the case repudiating the actions taken by the Federal Trade Commission attorneys assigned to the case, and, in effect, ordered that the hearings proceed.

The major legal issues presented by the complaint are apparent from the following brief excerpt from the complaint:

> "PARAGRAPH SEVEN: For more than three years last past the respondents have been parties to a combination and planned common course of action beyond the protection and immunity provided by the Capper-Volstead Act (Act of Congress, February 18, 1922, 7 U.S.C.A. 291, 292) or any other Federal Statute, to fix prices and control the distribution of citrus fruits and citrus products moving in interstate commerce from the State of Florida, and pursuant thereto and in furtherance thereof have done and performed and engaged in, among others, the following acts, practices and methods:
>
> "1. Acted to fix prices for and otherwise interfere with the free play of competition in the pricing of citrus fruit grown by respondents through arrangements, contracts, and agreements with handlers whereby handlers were obligated to follow rules, regulations, orders, and instructions of respondents concerning prices and shipment quotas, irrespective of whether or not title to said citrus fruit remained with respondents; and, further acted to fix prices for and otherwise interfere with the free play of competition in the pricing of citrus fruit grown by respondents by requiring handlers engaged in processing, canning, packing, selling and shipping citrus products to establish and maintain such prices for said citrus products as would not adversely affect maintenance of the prices established for citrus fruit by respondents.
>
> "2. Solicited and permitted the participation of handlers in the matter of the establishment of floor prices for citrus fruit and in the matter of shipping schedules for citrus fruit, and have sought the agreement of said handlers in these matters and did agree with said handlers on such matters.
>
> "3. Required handlers who had contracts with FCM to agree with FCM and its members, through FCM, to handle in and from the State of Florida only citrus fruit and citrus products of members of FCM, and to devote said handlers' citrus packing, processing, and canning facilities to packing, processing

and/or canning the citrus fruit only of members of FCM, subject to such exceptions as might be permitted by FCM, and, subject further to the understanding that if non-members' citrus fruit should be handled and purchased by said handlers, the handling of it by them should be governed by their contracts with FCM.

"PARAGRAPH EIGHT: The acts, practices, and methods hereinabove alleged have a dangerous tendency unduly to hinder competition and create monopoly and constitute unfair methods of competition and unfair acts and practices in commerce within the meaning of Section 5 of the Federal Trade Commission Act, as amended."

(R. J. MISCHLER)

COOPERATIVE'S COMMISSION NOT APPLICABLE TO BAILMENT TYPE CONTRACT

(Cash Crops Coop. v. Green Giant Co.)

In Cash Crops Coop. v. Green Giant Co., 57 N.W. 2d 376, decided on March 3, 1953, the Supreme Court of Wisconsin held that a Wisconsin statute, under which buyers of products from a member of a cooperative association are bound by a member's assignment of funds to the association provided specified formalities concerning filing of the assignment and notice to buyer are complied with, applies only where there is a sale of such products. The farmer-members of the cooperative had entered into contracts with a processor, under which they agreed to plant seed peas furnished without charge by the canning company, and harvest and deliver the crop to the company for a specified compensation based on the quantity delivered. On these facts, the court held that the reservation by the company of title to the seed and the crop to be grown therefrom was valid, and the delivery of the peas under the contract was not a "sale" (1) within a contract by which the farmer had assigned to the cooperative a percentage of the receipts from the sale of the products or (2) within the State statute under which the buyer of such products from a member of a cooperative association is bound to recognize the member's assignment of funds to the association.

In this case, Cash Crops Coop., an agricultural cooperative association, brought action to recover from the canning company the commissions to which it claimed to be entitled upon sales of peas made to the canning company by members of the cooperative association. The cooperative claimed to be entitled to such commissions by reason of contracts between it and its members, assigning to the cooperative a percentage of the receipts of produce raised by the members for sale. The canning company denied that its dealings with the cooperative members resulted in any sale of peas to the company. The lower court held in favor of the cooperative, and the canning company appealed. The trial court made the following findings of fact, which were not disputed:

"3. During and prior to the year 1948 plaintiff entered into uniform membership and marketing agreements in writing with its members who were Wisconsin farmers growing peas and other crops for canning purposes. In and by such

agreements said members agreed to sell to or through plaintiff association all their peas raised for sale and plaintiff agreed to act as bargaining agent for such members with respect to such peas. Each of said contracts provided for a partial assignment of funds in favor of plaintiff association in such amount as the association might direct, and authorized any buyer of produce covered by the agreement to pay to plaintiff association such amounts from the sale of such crops as the association should direct. Prior to 1948, plaintiff's Board of Directors had fixed such amounts to be paid by such buyers as 1% of the gross amount due such members for peas sold by such members; such action applied to peas sold by plaintiff's members in the year 1948.

"4. During 1948 members of plaintiff who had signed such agreements with plaintiff which were still in full force and effect for the crop year 1948 delivered to defendant at its pea canneries and viners in the state of Wisconsin peas for which they were entitled to receive the gross amount of Ninety two thousand nine hundred nineteen and 76/100 (92,919.76) Dollars from defendant.

"5. Such peas were delivered to defendant pursuant to a uniform form of contract applicable to the crop year 1948 entered into by and between defendant and each of the members of plaintiff who delivered peas to defendant. Such contracts were entered into before the peas delivered in 1948 had been planted.

"6. Prior to the time any monies became due to any of plaintiff's members for delivery of peas to defendant in 1948, plaintiff association had caused to be filed in the office of the register of deeds of the county in which each such member maker of such contract resided, a copy of such uniform contract of such member to sell to or through plaintiff association or a copy of such uniform contract together with a sworn list of names of all makers of such contracts residing in such county and such lists contained the names of all of plaintiff's members who sold peas to defendant in the year 1948 and were filed in the county in which each such member resided; such sworn statements contained the further statements that the uniform contracts and such sworn statements were filed pursuant to Section 185.08, Wisconsin statutes.

"7. After the date of such filing and prior to the date any monies became due to any of plaintiff's members from defendant for peas delivered in 1948, plaintiff association certified to defendant the names of such members who had signed the contracts and advised defendant that the membership contracts directed payment by defendant to plaintiff of 1% of the gross amounts due the growers for 1948 peas, in accordance with the action of plaintiff's Board of Directors.

"8. Under the provisions of defendant's uniform contract with its growers for the year 1948, defendant agreed that the net amounts due such growers should be paid on or before October 15, 1948. Defendant has at all times since such date failed and refused to make any payments to plaintiff on account of such assignments to plaintiff for 1948."

The Appellate Court described the contract between the individual grower and the canning company as follows:

> "In the contract between appellant canning company and the individual farmer we find the following pertinent provisions: The company agrees to furnish seed without charge for the same. Contractor (the farmer) agrees to prepare the soil and plant said seed on land approved by the company on his farm and agrees to furnish all machinery, equipment, labor and other facilities to properly plant said seed and to grow, harvest and deliver the crop in a good husbandlike manner. Contractor shall plant the aforesaid peas at such time, or times, as the company shall direct and shall harvest and deliver same to the company's viner station, and thresh the peas grown hereunder by him, at such time or times as the company shall designate. If contractor refuses to harvest, deliver, and thresh said peas at the time or times designated, the company shall have the right to perform any or all of said services and deduct the cost thereof from the contractor's compensation.
>
>> "'It is understood and agreed that Contractor acquires no right, title, or interest in and to the seed which is herein furnished him by the Company, nor the crops grown or harvested therefrom, and that he holds possession of the seed and the crop to be grown and harvested therefrom as a bailee only. The title to said seed and the crops that are to be grown and/or harvested therefrom shall at all times remain in the Company, and the entire crop, except as herein otherwise expressly provided, shall be delivered to the Company. All unplanted seed must be returned to the Company.
>>
>> "'In consideration of the above the Company agrees to pay the following compensation for green peas in proper condition for canning:' (Compensation rates per hundred pounds set forth.)
>
> "The company does not warrant any quality in the seed. It has the right to inspect the crop while growing. It may make recommendations for fertilization with which the contractor must comply, and the company has the right to treat the crop for pea aphids. Such part of the crop as the company does not accept for canning or seed may be retained by the contractor for feed or to be plowed under and he shall not be otherwise compensated for it, and he may keep the vines for silage. The contract concludes:
>
>> "'Contractor is not an agent or servant of the Company, and he shall have the exclusive possession of the property upon which the crop is grown; he shall not be subject to discharge, and he shall be deemed and held as an original contractor, and the Company has no control over him in the performance of this contract other than as to the results to be accomplished.'"

The following excerpt from the court's opinion indicates the basis of the court's decision:

> "By sec. 185.08(5), Stats., a person (or corporation) who purchases products from a member of a cooperative association is bound by the member's assignment

of funds to the association, if certain formalities concerning filing of the assignment and notice to the purchaser are complied with. It is admitted in the present case that the company had notice of the duly filed agreement between the cooperative and the grower of peas, but the statute has no application unless the grower is a seller of the peas and the appellant company a purchaser. It was the view of the learned trial court that regardless of the attempted reservation of title in the contract between the company and the grower, title to the peas was in the grower and was later acquired by the company through purchase and sale. The seed peas were originally the property of the company. It is not contended that the company sold them to the grower nor did it make him a gift of them. By its contract the company professed and intended to retain ownership of the seed and of the new crop into which the seed was transformed by the process of growth. If this ownership was satisfactory to the contracting parties we see no reason why they may not so agree and have their agreement effective in the absence of some statutory prohibition. We have found no statute and have not been referred to any which says that parties may not make a valid agreement that one of them may contribute seed and the other land and labor and that title to the seed and the crop which grows from it shall be retained by the former. None of our previous decisions hold that such an agreement for the retention of title is invalid. Two of them expressly recognize the validity and effectiveness of such a reservation. Lanyon v. Woodward, 1882, 55 Wis. 652, 13 N.W. 863, and Romey v. Rock County Sugar Co., 1915, 159 Wis. 552, 150 N.W. 981.

"Since title to the peas from seed to harvested crop was reserved in the company they could not be sold to the company by the grower and their delivery and the compensation for growing them was unaffected by the contract of the cooperative with its members or by sec. 185.08(5), Stats., both of which are limited by their own terms to transactions involving a purchase by the company and a sale by the member."

In addition to the foregoing, the Appellate Court reviewed the various reasons considered by the trial court for holding that the arrangement constituted essentially a sale. The trial court attempted to discover where title was by an analysis of various contract provisions. The Appellate Court did not concur in this analysis, however, and considered none of the factors mentioned by the lower court as controlling.

(R. J. Mischler)

INITIAL DECISION RENDERED IN FEDERAL TRADE COMMISSION CASE AGAINST APPALACHIAN APPLE GROWERS AND PROCESSORS

(In the matter of The C. H. Musselman Co., et al. -- Doc. No. 6041)

In an "Initial Decision," dated April 15, 1953, the Hearing Examiner entered an order granting motions to dismiss the complaint in the Federal Trade Commission's case against The C. H. Musselman Company, National Fruit Product Company, Inc., Knouse Foods Cooperative, Inc., Bowman Apple Products Co., Inc., Shenandoah Valley

Apple Cider & Vinegar Corporation, and Appalachian Apple Service, Inc., an incorporated trade association.

The Commission's complaint had charged in substance that Appalachian Apple Service, Inc., an incorporated association of apple growers in Virginia, West Virginia, Maryland, and Pennsylvania, entered into "an understanding, agreement and combination" with the other corporate respondents, all of whom buy raw apples from growers for processing, to

1. fix, stabilize, and maintain prices to be paid for apples;

2. fix, devise, and establish a mathematical percentage pricing formula for the different grades of apples;

3. divert shipment of raw apples from one or more processors to others in order to maintain prices and price scales.

Sixteen hearings produced 2,020 pages of transcript from 29 witnesses and 392 exhibits, totaling another 1,000 or so pages. At the conclusion of this proof-taking, respondents moved to dismiss "for insufficiency and lack of substantiality of the evidence to make out a prima facie case."

In an opinion some 26 pages long, the Hearing Examiner analyzes the evidence produced and reaches these conclusions on the three main points of the complaint:

> "Considering the record now as a whole instead of piecemeal on the charges of price fixation and maintenance, the Examiner is of the opinion that there is insufficient reliable, probative and substantial evidence to sustain the charges and support the order requested. This turns on the difficult allocations of weight and credibility. If these are determined as urged by counsel in support of the complaint, then there is here not only a reasonable, but a strong inference of the conspiracy charged. But the Examiner, from his observation, is unable so to do, and he has hereinabove, in an effort to make clear to counsel and the public, discussed what he has relied upon and what he has rejected and why, to what he has given weight, and in what degree, which has extended this opinion to what would be otherwise unjustified length.
>
> "In observance of the principle that a contemporaneous writing before litigation more accurately depicts the facts than postlitigation testimony based on recollection and influenced by a desire to tone down or dispel implications, the Examiner has given full weight and credit to such writings except where they, on their face, indicate the same exaggeration which festooned the writer's rejected testimony, or where they were in contradiction to some independent and uncontradicted fact, evidenced either by an unquestioned document or unanimity of testimony by credible witnesses, which, in each instance, has hereinabove been noted. Some documents had this in spite of the impression that much was the extra factual effluvia of an over-ambitious promoter, and that it seems anomalous to believe writings not under oath when the writer is disbelieved under oath. There is no doubt from them that the AAS secretary wanted to fix, stabilize and maintain prices, urged it and may have thought he achieved it--but stubborn and unquestioned facts belie it, in the Examiner's opinion. Assessing weight and credibility as the

Examiner has, the factual picture is not one from which one of two equally reasonable but opposite inferences may be drawn. Rather it presents a picture, suspicious of the conspiracy charged, indicating repeated but abortive attempts to agree and a contrary strong and reasonable inference of independent pricing.

* * * * * *

"The Examiner is of the opinion that no prima facie case has been shown to support the second charge.

* * * * * *

"In sum, the evidence is at least conflicting, contradictory and far from clear as to any agreement to divert, the evidence is preponderant that there was no substantial diversion, and the conclusion is that the evidence as a whole is insufficient to sustain the third charge of the complaint."

(R. J. Mischler)

CONTRIBUTIONS TO NTEA AGAIN HELD NONDEDUCTIBLE

(American Hardware & Eq. Co. v. Com. of Int. Rev.)

In American Hardware & Eq. Co. v. Commissioner of Internal Revenue, 202 F. (2d) 126 (C.C.A. 4th), decided February 17, 1953, the court sustained the decision of the Tax Court (see Summary No. 55, p. 12) that contributions to NTEA, which was organized and primarily operated from its inception during taxable years in question for carrying on propaganda with ultimate objective being revision in tax structure, was not deductible as an ordinary and necessary business expense or as a contribution to a scientific or educational corporation.

The principal contention of the taxpayer in this appeal was that no substantial evidence was presented to the Tax Court to justify its crucial finding of fact upon which the decision was based. The Appellate Court, after reviewing the evidence before the Tax Court, said:

> "Confining consideration to the evidence offered by the taxpayer alone, it is obvious that the Association has been primarily operated for the issuance of propaganda with the ultimate objective of securing a revision in the tax structure, and has endeavored to carry out the objects and purposes set out in its charter, to conduct educational and research activities relative to the disparities in federal and state statutes affecting business and to disseminate information to civic organizations and representatives of business affected thereby and to the public and to federal and state governments. No further statement is needed to show that the Tax Court's findings of fact were abundantly supported by the evidence."

(R. J. Mischler)

BUREAU OF INTERNAL REVENUE EXTENDS DEADLINE FOR FILING COOPERATIVE INCOME TAX RETURNS

On May 22, 1953 the Bureau of Internal Revenue issued Amendment No. 1 to IR-Mimeograph No. 135 anouncing a further extension of time for the filing by "exempt" farmers' cooperatives of their annual Federal income tax return on Internal Revenue Form 990-C. This replaces Form 990 previously required to be filed annually.

The time for filing Form 990-C, for any taxable year that begins within the year 1952, is extended to the 15th day of the ninth month following the close of the taxable year. The extension does not apply to taxable years beginning in the year 1953 or subsequent years.

For example, an association whose taxable year began on January 1, 1952 would have until September 15, 1953 for the filing of Form 990-C. One whose taxable year began on December 1, 1952 would have until August 15, 1954.

While the time for payment of any tax that may be due is also extended, the Bureau points out that this will not relieve a taxpayer from the payment of interest at 6 percent per annum from the original filing date, namely the 15th day of the third month following the close of the taxable year. This means that associations having a tax to pay and wishing to avoid the payment of interest should file their return and pay the tax on the original filing date. Alternatively, such associations could avoid an interest payment by making an advance payment of estimated tax on the original due date, with filing of the actual return being deferred until the extended due date.

Further information on this extension of time, along with a facsimilie of the Bureau's notice thereon, may be found in Revised Supplement No. 3 to Miscellaneous Report 156, issued by Cooperative Research & Service Division, Farm Credit Administration, Washington 25, D. C.

* * * * * *

The November 8, 1952 tentative regulations covering the tax treatment of "exempt" cooperatives, and of the patrons of all cooperatives, have not yet been made final. When such regulations are finally adopted by the Commissioner of Internal Revenue, the Cooperative Research & Service Division will publish them with comments as Revised Supplement No. 2 to Miscellaneous Report 156.

(George J. Waas)